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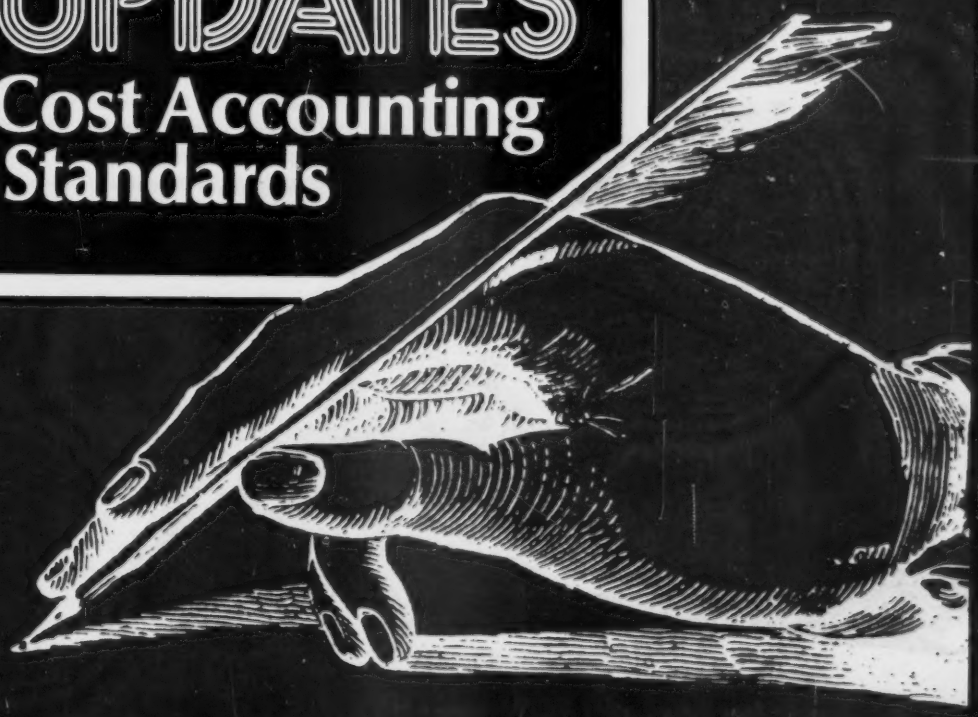
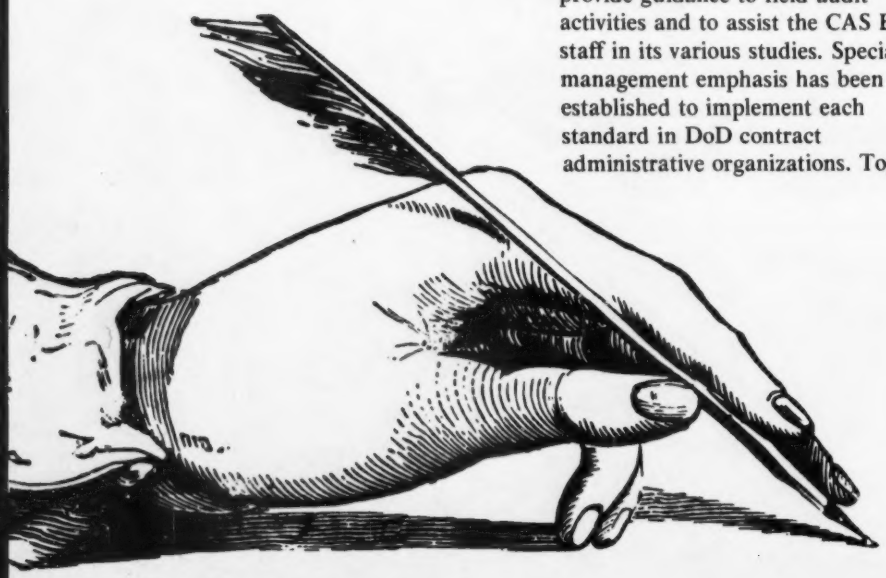
DOD UPDATES

Cost Accounting Standards



The Department of Defense (DoD) has supported the need for Cost Accounting Standards (CAS) Rules and Regulations and is providing substantial assistance to ensure successful implementation. Five major areas pertinent to CAS will be discussed in this issue. These are:

- DoD Actions to Implement CAS.
- DoD Policy Prior to CAS.
- CAS Administrative Problems.
- CAS Application Problems.
- Actions to Improve CAS Administration.



DoD ACTIONS

Since the inception of CAS, DoD has been aware that the new standards and regulations would require a special start-up effort to assure proper implementation and administration. Following is an enumeration of some of the actions taken by the Defense Department.

To assure adequate coordination, the CAS Board staff has been provided full access to all DoD personnel to assist in the development of new standards. The Armed Services Procurement Regulation (ASPR) Committee and other top policy personnel have been utilized on a priority basis to respond to proposed CAS promulgations. In the Defense Contract Audit Agency (DCAA), a CAS branch was established to provide guidance to field audit activities and to assist the CAS Board staff in its various studies. Special management emphasis has been established to implement each standard in DoD contract administrative organizations. Together with the CAS Board staff the Department of Defense prepared and conducted a series of CAS training seminars for Government personnel all across the Nation. In addition, other special training seminars have been conducted by the Defense Contract Audit Agency, the Defense Contract Administration Services (DCAS), and the Air Force. Finally, a two-week training course was developed and is currently in operation at the Army Logistics Management Center, Ft. Lee, Virginia, to provide intensive CAS training to DoD personnel.

DoD also has recognized the need for additional personnel to administer the CAS program. Since 1973, many additional personnel have been authorized for DCAA and DCAS, who have the bulk of the administrative work load. Field activities have estimated that in Fiscal Year 1975 more than 275 man-years have been devoted to the administration of CAS.

In short, DoD has been diligent in its efforts to get CAS off to a good start.

PRIOR POLICY

At this point the procurement environment that existed prior to CAS will be discussed. This should help in understanding the effect of the change that took place when CAS came on the scene.

Prior to CAS, DoD addressed cost

DoD Supports New Rules and Regulations For Cost Accounting

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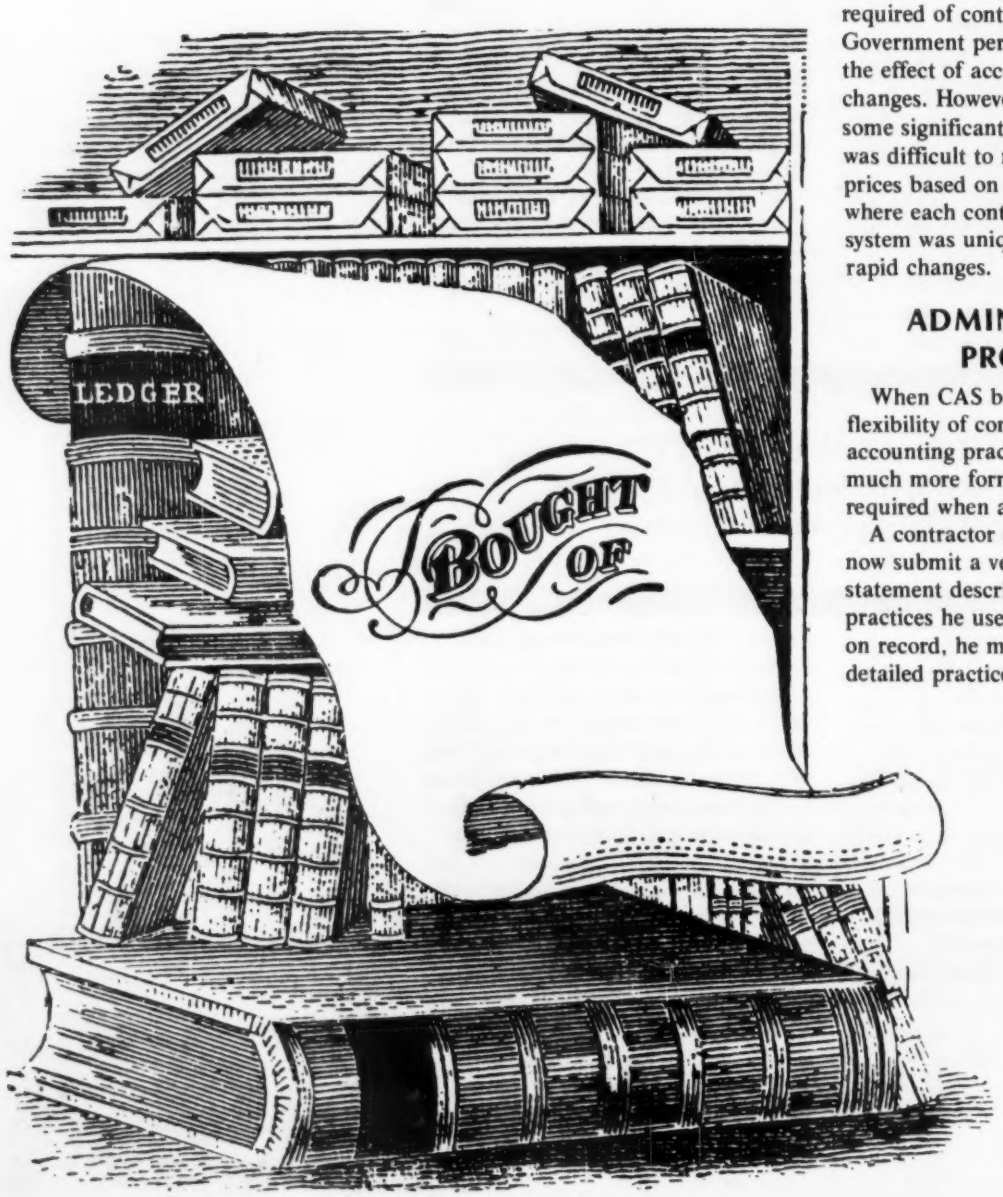
allocation through its ASPR cost principles. Contractors were required to follow "Generally Accepted Accounting Practices" as promulgated by the American Institute of Certified Public Accountants (AICPA) and other recognized authorities which have, for many years, formed the basis for accounting in the United States. Other ASPR guidance dealt with direct and indirect costs, and some cost principles contained specific provisions on cost allocation. Examples are Independent Research & Development (IR&D), Bid and Proposal (B&P) compensation for personal services, and depreciation.

Cost principles permitted flexibility in accounting practices, and voluntary changes in contractors' practices could be accommodated with a minimum of administrative effort. Resultant contract cost increases and decreases were reviewed by auditors and contracting officers and judgments made as to the overall impact. Usually, the changes were phased in with no requirement to amend existing contracts, and the degree of formal review and documentation was minimized.

Thus, DoD did not lack for rules on cost allocation, but had nowhere near the detail or number of rules that are evolving under the Cost Accounting Standards.

New ASPR rules were only applied to new contracts beginning at some future period to minimize administrative work load. DoD has found that, by delaying the effectivity date, usually to coincide with the start of a future fiscal year of the individual contractors, both contractors and DoD procurement personnel have had time to assess the effect of the new rule and plan mutually acceptable adjustments to the contractor's accounting practices, so that the change could be smoothly integrated. Since the change only affected new contracts, the impact was gradual as old contracts phased out and new contracts took their place. Finally, temporary deviations were granted by DoD to deal with unusual problems.



The point to be made here is that there was a high degree of flexibility that existed prior to CAS. In addition, Defense procedures allowed DoD to minimize the administrative effort required of contractor and Government personnel in dealing with the effect of accounting system changes. However, the system did have some significant problems in that it was difficult to negotiate contract prices based on a contractor's cost where each contractor's accounting system was unique and subject to rapid changes.

ADMINISTRATIVE PROBLEMS

When CAS became effective, the flexibility of contractors to change accounting practices was reduced. A much more formal procedure is required when any changes are made.

A contractor subject to CAS must now submit a very detailed disclosure statement describing the accounting practices he uses. Once this is placed on record, he must follow those detailed practices in full or be in

violation of the CAS regulations. If he desires to change a practice, it must be submitted to the administrative contracting officer for review together with a detailed analysis of the cost impact on a contract-by-contract basis. Contractors have told DoD that the effort involved in this procedure, when a large number of contracts are involved, is so onerous that they are reluctant to make changes voluntarily, even though the changes may be desirable improvements that are supported by the auditor and contracting officer. DoD's experience thus far indicates that preparation of contract impact data by the contractor, review by the auditor and contracting officer and subsequent negotiation of contract adjustments can truly be an undertaking of major proportions. The Defense Department also is concerned that even though the impact may not be significant, a formal review and documentation is required.

Under present regulations, any change in accounting practices, whether voluntary or based on a new standard, requires the contractor to analyze the impact on all CAS – covered contracts and subcontracts. Some of these may be fixed-price, some incentive and some cost type. Each is affected in a different way by a change in cost allocation. For a major contractor with several hundred contracts, this review can become an enormous undertaking. Subsequent modification of all these contracts involving many fund citations of different military Departments and even other agencies further exacerbates the problem. Moreover, the lack of precedents and experience to guide contracting officers and contractors in the settlement of CAS issues causes delays and additional work as the participants seek solutions to new problems.

The rigidity of CAS in its application to contractors plus the understandable caution of DoD contracting officers in resolving issues have served to create extremely complex administrative problems. Additional policy guidance and training which the Department of Defense is developing, together with experience, should alleviate many of these, but DoD shall continue to seek improvement in its administrative practices.

APPLICATION PROBLEMS

It is important to turn now to the problem DoD faces when a supplier adamantly refuses to accept a contract containing the CAS clause. Fortunately, this happens very infrequently; but when it does, and the firm is the only one which can provide a particular product or service, DoD finds itself in a situation that almost defies solution. It must first be recognized that the Defense Department does all possible to convince a contractor that he should accept the clause and that DoD cannot contract unless he does. This often fails because the contractor is aware that DoD can request a waiver of the CAS requirement. When driven to this action, the Department of Defense requests waivers because, frankly, there is no other course of action. Some have suggested that DoD immediately invoke the provisions of the Defense Production Act which would require a contractor to perform. However, the DoD has serious doubt that this is a workable solution. The Cost Accounting Standards Law prevents DoD from contracting without inclusion of the CAS clause or obtaining a waiver, and without a contract there is no basis for the

Government to take delivery and pay for the needed supplies even if ordered under the Defense Production Act. It is Defense's understanding that the Director, Office of Preparedness, General Services Administration, has stated in his letter of July 17, 1975, that refusal to comply with the Cost Accounting Standards cannot be considered a refusal to produce under a priority order.

DoD also has had difficulty with foreign companies. They are usually nonreceptive to the CAS provisions which, to them, represent regulatory provisions of a foreign government. From a practical standpoint, DoD has no leverage to require acceptance of CAS by foreign contractors with which the U.S. Government is required to contract.

In addition, the lack of an exemption for firm fixed-price contracts awarded on the basis of price competition is not appropriate in DoD's opinion. There are situations where formal advertising cannot be used, but award is based on price competition and cost data is not needed. Such contracts should be exempt on the same basis as advertised awards. This would also serve to bring the administration of CAS closer to the procedures of Public Law 87-653.

As CAS evolves, the belief is that it should have primary application to large Defense contractors. It is essential that such contractors be the main concern since most Defense dollars are spent with such companies. On the other hand, other companies, some very large, whose primary business is with non-Defense customers are oriented to different types of accounting methods, because their production methods are different from those in Defense industry, or their customers do not require the type of cost data desired by Government procuring activities. These companies often resist CAS and refuse to change their accounting systems to conform to the standards. Even when they accept CAS, they often do not change their accounting practices but simply keep separate records for the few CAS contracts they have. In some cases they have indicated an intention to withdraw from Defense business. DoD is

concerned that this not lead to reduced competition or less qualified suppliers.

IMPROVEMENT ACTIONS

DoD is currently taking a number of actions which it is believed will contribute to improving CAS implementation.

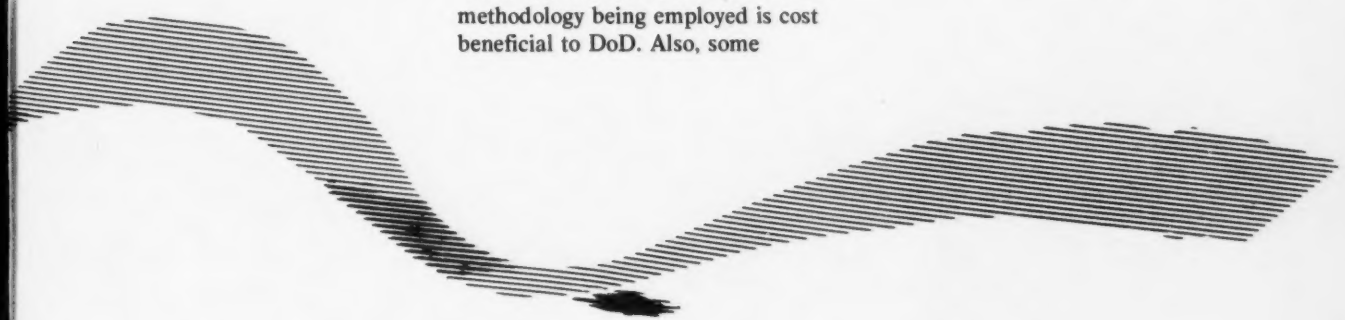
The first of these actions is the establishment of a central group to enhance response to CAS problems.

This operation has just been established to focus high level attention on CAS problems. There is a working group made up of representatives from top level policy offices of the Military Services, Defense Contract Administration Services, and Defense Contract Audit Agency. Under the chairmanship of an Office of the Assistant Secretary of Defense (Installations & Logistics) representative, this group will actively seek out CAS administration problems and provide interim guidance and assistance to field activities. The intent here is to furnish a quick reaction to field problems and to make policy people available to field personnel for consultation and assistance. The working group will set up a reporting and tracking system, will publish instructional material, and will initiate proposals for changes in ASPR. The group will also be responsible for evaluation of field practices and expediting the processing of CAS actions, ASPR policy, and CAS regulations and will establish a hot-line service for field organizations. All this will be under the overall guidance of a CAS Steering Committee consisting of the Assistant Secretary on Defense (Comptroller), the Military Department Installations and Logistics Secretaries, and the Director, Defense Supply Agency.

The second action involves a training program. The CAS training program at Fort Lee, Virginia,will continue to train contracting officers, price analysts, and auditors. DoD's plan is to train approximately 150 people in FY 1976. This is seen as an on-going program that will be necessary as long as new standards continue to be published.

The third action in improving CAS implementation is a cost effectiveness study.

In view of DoD's significant resource investment in implementing the Cost Accounting Standards, Defense wishes to ensure that the methodology being employed is cost beneficial to DoD. Also, some



contractors have indicated that the current approach in applying CAS standards may be more costly than the benefits derived. In an effort to get a better understanding of the cost effectiveness problem, the Department of Defense has recently established a study project which has been assigned to the Army Logistics Management Center at Fort Lee, Virginia. DoD expects this work to be completed within a few months and is hopeful that it will produce information and recommendations for revising administrative practices, or even the CAS Board rules and regulations.

Finally, DoD is implementing exemptions and other changes.

There are four areas where exemptions and other changes in CAS implementation should be considered. On March 12, 1975, the Department of Defense wrote the CAS Board to request their consideration of establishing an exemption for any contractor's profit center with less than 5 per cent Defense work. In Defense's view, it is unrealistic to expect a contractor to agree to follow CAS regulations which will increase his administrative cost, require changes in his accounting practices, and eliminate his flexibility to make accounting system changes to accommodate a very minor part of his total sales. His reaction is likely to be an uneconomic decision to segregate Defense work or discontinue taking Defense contracts. The CAS Board is currently reviewing this proposal.

In addition to the 5 per cent exemption, DoD is also preparing requests to the Board to exempt foreign prime and subcontractors, and firm fixed-price contracts awarded on the basis of price competition.

The fourth area is the need for further clarifications, interpretations, and definitions from the CAS Board. For example, it is suggested that the Board define the term "cost accounting practices", interpret the meaning of "increased costs", and indicate the latitude allowed in the application of offsets in contract price adjustments. DoD expects to work closely with the Board in developing these definitions and interpretations.

In summary, it is believed DoD is fulfilling its responsibilities in the implementation and administration of Cost Accounting Standards. The problem is basically one of struggling with a new and complex program. DoD has been working and will continue to work to develop solutions for overcoming the difficulties being experienced.

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